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Chairman's Letter

Exciting changes have swept the field of global healthcare since I last addressed you. From this sea of change, three developments stand out, I call them waves, in terms of the profound impact they are likely to have on shaping the future course of the healthcare industry. These are: 1) The wave of revolutionary technologies like genomics, 2) The wave of spreading information technology; and 3) The wave of intense desire to control spiralling healthcare costs. All these waves have started acting separately and collectively to create a powerful force which is already causing far-reaching impact on the workings of our industry. In this context, it is very important and pertinent for me to share with you what strategies we at Nicholas Piramal are planning to successfully navigate and even shape these waves.

The Genomic Revolution

I had briefly talked about the building up of this wave in my last letter to you. Since then, the human genome has been mapped opening up many exciting vistas for the healthcare industry. Genomics will enable us to understand which genes are related to specific diseases, making it easier to develop targeted drugs faster and eventually to customise medicines to the unique genomic make up of a person. While this will make future medicines more effective and side-effect free, it will also increase manifold the number of molecules available to treat a single disease. The key point is that a succession of breakthroughs in pharmaceuticals and equivalent advances in other medical technologies will inevitably have a powerful expansionary influence on demand and utilization patterns in all systems where they are introduced.

However, actual value creation from genomics is likely to be only in the distant future. At the moment, it is putting increasing cost pressure on drug discovery research because of the large investments required upfront. To reduce this pressure, leading pharmaceutical companies of the world are merging, acquiring and allying. Consolidation is happening at a furious pace because access to resources, monetary and intellectual, has become the key to success in the genomics game.

The Information Technology Wave

The information technology wave is an all-encompassing wave covering almost every human activity. Not withstanding the e-commerce slowdown, internet and related technologies will transform healthcare in many ways, including potential efficiency gains in all aspects of healthcare management. They will amplify the power of consumer choice in healthcare as in all other transactions and as a result healthcare systems will feel intense and growing pressure towards transparency in decision making.

Introduction of direct to consumer marketing on a trial basis in the US has already had profound impact on consumer behaviour and marketing game-plans of companies there. Doctors are increasingly facing a much more knowledgeable patient who is demanding why a certain medicine is being prescribed to him. Though it is not going to change the fundamental role of a doctor – to diagnose the disease – it is going to have far-reaching impact on the treatment methodology. Transparency and cost effectiveness will become the cornerstones of future interactions between patients and doctors.

This wave will have mixed implications for healthcare companies. On the positive side, they will be able to communicate the genuine benefits of high quality modern medicine directly to the final consumer while on the negative side, an enlightened consumer population will put increasing pressures on issues such as pricing.

The Cost Control Wave

A rapidly greying population is putting tremendous strain on the health budgets of most developed countries. The governments there are increasingly looking for ways to reduce this growing burden. Many countries in Europe and Japan already have price caps on patented medicines. In the US, where there are no such caps, healthcare organizations are actively encouraging generic medicines costing a fraction of patented medicines. As a result generic drugs are expected to rapidly gain market share in the US.

All these developments are driving research oriented large pharmaceuticals companies to focus on something they have rarely done before - reduce costs in every possible manner. The companies are responding by consolidating and outsourcing. Economies of scale has become a buzzword.

What does it mean for India?

This brings us to an important question - what implications does this have on India in general and Nicholas in particular.

What is clear to us is that all these developments present tremendous opportunities in diverse areas to Indian Pharma. India with its large, multiethnic, science educated and English-speaking population is uniquely placed to capture a large share of many of these opportunities. An additional benefit is the proven success of India in the field of information technology. The confluence of these two puts India in an advantageous position vis-à-vis other competing countries. In fact, a recent FICCI-McKinsey study articulates an opportunity for Indian Pharma to grow from its current size of $5.5 bn to nearly $25 bn by 2010, and $100 bn by 2025.

However, capturing this opportunity will require significant effort and dramatically new strategies. Many of these opportunities are still at an evolutionary phase, particularly those related to genomics. Areas like bio-informatics, proteomics, structure based drug design, gene therapy etc. are still largely at a conceptual stage. Therefore, it is very difficult to decide where to play and how to play from a plethora of options available. In some well-established opportunities like contract research and clinical trials, there are social and political issues. While in generics, a large but highly competitive field, Indian companies will need to transition from being exporters of intermediate, bulk and formulation drugs largely to unregulated markets to becoming world players especially in the regulated markets of US and Europe.

One major issue facing Indian companies today is the enforcement of product patents in the domestic market from 2005. This may not have immediate impact on the market, but by 2010-2015, a significant share of the domestic market is likely to be captured by patented medicines leaving a large but highly competitive market for players in branded generics. Large MNCs are looking at the Indian market with renewed interest and post 2005 many of them will pose stiff challenge to Indian players, a fact borne by what has happened in the Brazilian and Polish markets in the last 5 years.

We have been analysing implications of these issues and have developed many options to address them. To assist us in evaluating these options in a systematic, logical and objective way, we have engaged McKinsey & Company, a premier strategy consulting firm.

Emerging Strategies

At the time of taking this letter to the press, the McKinsey Study is still in progress. However, broad trends have started emerging.

The study predicts a large and buoyant Indian pharmaceutical market but sees a significant share for patented drugs by 2015. Accordingly we intend to strengthen our domestic formulation business further. We are merging with RPIL and as a combined entity intend to address this opportunity with renewed vigour and ambitious goals utilizing our formidable strengths in well established brands, doctor reach, manufacturing facilities, sales and distribution infrastructure, relationship building with MNCs and human resources.

The study also validates our earlier analysis that opportunities exist for our products and services in the global markets. Mckinsey is assisting us in crafting a sustainable global markets entry strategy. Such a strategy is important for us because in a rapidly globalizing industry while an India-focussed approach to our formulations business is sustainable, it will be both anachronistic as well as unviable when it comes to newer global opportunities in healthcare. Exports of Generic formulations, herbal remedies, custom chemicals, contract research and support services, clinical trials, bio-informatics are some of the potential areas we are exploring for our global foray.

I foresee, Nicholas continuing to follow a three-pronged approach to reach our goal of becoming one of the leading pharma company in India and a significant niche, global player.

Investment in businesses of future

I had shared with you my belief in investing in businesses with serious and sustainable future business potential such as discovery research and development of patentable new products. In the light of the new developments, my belief has been reinforced further and I see our investment in Quest Institute of Life Science (QILS) as key to our success in the future.

To strengthen our R&D base and enter the highly promising field of Genomics, we have entered into an exclusive three years alliance with the reputed Centre of Biotechnology (CBT). This alliance catapults us into forefront of the research in this field in India and gives us access to the modern facilities and valuable databases available with CBT. As pointed out by McKinsey, there are numerous opportunities available in the fields of research and we are looking at them from a sound base of QILS and CBT with a sense of excitement.

Pathlabs and a whole range of services in contract research are the two other areas we are seriously looking at as future business opportunities. Compared to fundamental research, these opportunities have a low gestation period and can play a big role in generating resources to be invested in research.

Organic Growth in formulations through Focus

Through our presence in the pharmaceutical industry for over 12 years and after several acquisitions, we now have 16 brands in the top 300 pharmaceutical brands in India. These brands have tremendous equity and, with proper focus, can be leveraged to generate good volumes and hence profits.

We have strengthened our organization and streamlined our processes to make a focused market thrust for our key brands. We are also rationalizing our brand portfolio to bring out a cohesive and sustainable brand basket addressing profitable therapeutic areas with future potential.

Relationship Building through Alliances

Building relations and nurturing them is one of our key strengths. Over the years we have built many lasting and strong relationships with some of the world's leading pharmaceutical companies such as Roche, Boots, Allergan, etc. We intend to strengthen them further by looking at newer areas of engagements like contract research and manufacturing.

Our strengths in adding significant value through mergers and acquisitions are now very well documented. In December we acquired Rhone Poulenc India from HMR. With this acquisition we are now the second largest pharma company in the domestic market. This acquisition has brought us some valuable brands like Phensedyl , Tixylix, Phenergan etc. We intend to merge RPIL with us, but will keep it as a separate division to leverage its unique position in some of the therapeutic areas. In the future, we will continue to look at any attractive opportunity to grow inorganically.

Concluding Remarks

We have always been a very proactive organization and have tried to exploit potential opportunities before they became bandwagons. Many times we have succeeded and sometimes we have not. With every passing day, we know better our strengths as also our shortcomings. We know that the environment is changing faster and more fundamentally. We are aware of the need to be even more proactive to sustain our growth rates and our premier position in the industry. With your continued encouragement, support and guidance I am confident that we will navigate and shape the waves of opportunity before us and rapidly stride towards our goal of making Nicholas the most admired pharmaceutical company in India, and one of the emerging global players

Management Review 2000-2001

For NPIL it was a year of satisfactory performance. The company as a whole achieved sales of Rs. 567 crores which represents a revenue growth of 17% over the previous year. However, our strong 26% growth in the Pharmaceutical i.e. formulations business deserves a special mention as it contrast so significantly with the 9% and 7.2% growth of the Industrywide Pharmaceutical formulations business as indicated by both the Shop Audit Reports of ORG & IMS respectively.

The Profit after Tax was Rs. 66.7 crores and represents a growth of 20% over the previous year.

Also in line with our strategy, to use mergers and acquisitions to attain critical mass, a significant achievement during the year was our acquisition of Rhone Poulenc (India) Ltd. (through our wholly owned subsidiary NPIL Fininvest). This is not reflected in the results of the Company for the current year. With this acquisition, the pharmaceutical business within the Piramal group along with all its joint ventures, has consolidated its position to be No. 2 in the domestic pharma industry (using the ORG data base for formulations retail audit). Also it now ranks No. 2 with 16 of the group brands ranking among the top 300 brands in the industry (as per ORG) .

Revenue break-up :

	Percentage to Sales %	F-2001 (Rs.Crores)	F-2000 (Rs.Crores)	Growth %
Formulations	75	424	336	26
Diagnostics & Patient Care	11	65	63	4
Vitamin A & Premixes	13	74	76	(2)
Others	1	4	12	(69)
Total	**100**	**567**	**487**	**17**

FORMULATIONS :

Industry Scenario

For the second year in succession the Pharma industry has shown a single digit growth, which is much below the normal growth trend in excess of 15% in the past. The slow growth rate of the industry was mainly influenced by the lack lustre growth in the anti-infectives segment of the market which constitutes 20.5% of the total market. This important segment, according to ORG showed a growth of mere 4%. This was partially due to influx of low priced generics and the downward price revision in major anti-infective molecules by NPPA (National Pharmaceutical Pricing Authority). However, the scenario is not that gloomy for the enterprising companies and the averages do not tell the complete story. Market segments representing “life-style” diseases such as Anti-Diabetics, Cardio-Vasculars, Neuro-Psychiatry and critical care segments like Oncology and Virology continue to grow at higher rates. Further, launch of new molecules continues at a furious pace in the context of the pending threat of the patent regime. New products are being increasingly used to achieve growth by the Indian sector companies. We therefore expect the market to return double digit growth rates in line with the historical long term trend.

Performance of various therapeutic segments:

Therapeutic segment	NPIL: Major Brands	% to sales	Market Growth % (ORG)	NPIL Growth % (Internal)
Anti-Infectives	➢ Paraxin ➢ Bactrim ➢ Genticyn ➢ Omnatax	17	4	6
Cardio-Vasculars	➢ Sorbitrate ➢ ISMO ➢ Enace-D ➢ Calaptin ➢ Cytogard ➢ Bezalip	14	19	20
Nutritionals	➢ Becozym C Forte ➢ Supradyn ➢ Redoxon ➢ Exerge	14	6	71
Anti-Diabetics	➢ Euglucon ➢ Semi-Euglucon ➢ Glimer ➢ Gluformin ➢ Diabetrol	5	35	57
CNS	➢ Rivotril ➢ Librium ➢ Valium ➢ Assert	5	14	10
NSAID's	➢ Rejoint ➢ Orthobid ➢ Micropyrin ➢ Multigesic	4	16	58
Respiratory	➢ Deletus	3	13	9
Biotek	➢ Recormon ➢ Neupogen ➢ Cellcept	8	—	43
Others	➢ Haemaccel	30	—	18
Total	➢	**100**	**—**	**26**

Company Performance

As against the sluggish industry performance, the company grew by 26% in formulation sales. Out of this, new products and acquired brands contributed to 14% growth. Though the anti-infectives contribute 17% of total sales, we have consciously focused our greater attention on the faster growing segments as a part of our strategy. In the current year, in the anti-infective segment we managed to grow by 6% over last year whereas the industry growth was only 4%. Our growth was affected partly due to downward price revision on both Bactrim and Omnatax during the second half of the year. We launched Omnatax-O (Cefixime) during the last quarter to broaden our position in the oral anti-infective segment and the brand is expected to be a major contributor to growth in the coming year. As mentioned earlier, keeping in mind the changing disease pattern and the increasing growth potential, we have focused our attention on new product introductions in the key therapeutic segments of Cardiovasculars and Anti-Diabetics. The addition of new products with increased promotional focus on these two therapeutic segments resulted in growths of 20% and 57% respectively for NPIL in these segments.

Rejoint – a novel product for Osteo-arthritis was launched towards the end of F-2000. The brand was received well by the medical fraternity. Rejoint achieved leadership position in the segment and closed the year with sales of more than Rs.8 crores in the very first year of launch. The brand was recognized as the second most successful launch for the current year. We plan to launch a few line extensions of this product. We further plan to launch several new natural products across therapeutic categories.

Nutraceuticals – The therapeutic segment of neutraceuticals for NPIL showed a growth of 71% over last year. Haemaccel, the brand acquired last year from Hoechst Marion Roussel continued to do well in the current year. The challenge in this segment will be to meet specific nutritional needs associated with major disease patterns in India. NPIL is in the process of developing new products in these areas and at least two of them will be introduced in the coming financial year.

Biotek : The Biotek division which markets products of F. Hoffmann La Roche and Nexstar continued to grow at a significant pace achieving a growth rate of 55% and maintaining a leadership position in several product categories. The biotek division remained leader in its field and successfully launched new products in the critical areas like Oncology, Virology and Nephrology. The immuno-supressant product Cellcept achieved sales of Rs.6.2 Crores which was highest for a critical care product in the first year of introduction.

During the year we launched 10 new products. The details of the new products are as follows:

Brand	Molecule	Therapeutic Category
Rexib	Rofecoxib	COX II inhibitor
Stator	Atorvastatin	A new generation Statin for lowering cholesterol levels.
Piozone Glimer	Pioglitazone Glimepiride	Anti-diabetic
Immumax	Tinospora	Immuno modulator
Zidime Omnatax-O	Ceftazidime Cefixime	Anti- infectives
Xeloda Mabthera	Capacitabine Rituximab	Oncology
Zenapax	Daclizumab	Nephrology

The New Products alongwith the acquired products contributed 14% to overall formulations sales in F-2001.

Diagnostics:

The overall growth in this division was mere 2% mainly because of the restructuring in both “Lab diagnostic and hospital product division”. The patient care group maintained the leadership status despite strong competition from leading multinationals in the glucometer business. With significant increase in installations of state of the art “Elecsys” and launch of “Cobas Care II” the Lab diagnostics division will have access to the highly specialized segments of the Immunodiagnostic business. The hospital products division is currently undergoing restructuring with prunning of non-profitable alliances. The positive impact of the same will be seen in the next year. This division is normally expected to grow in the range of 20%.

Vitamin A:

Despite significant improvement in the productivity and various cost reduction initiatives, the sale of Vitamin A business did not show significant growth. The profitability of the division however, was substantially better than the previous year due to the various cost containment measures and product mix changes.

In the initial part of the year, production was affected due to closure of plant operations for undertaking yield improvement measures. The low growth was also due to low cost imports and reduced demand from the user industries. Various measures have already been initiated to be competitive in this aggressive market. Also the division is successfully diversifying into the area of speciality and perfumery chemicals.

Research :

The company did considerable progress in various research initiatives undertaken in the recent past.

- NCE Research: The NCE research with five projects in four therapeutic areas is progressing well. The progress on two of them is significant and they have been evaluated and approved by external experts for further development. The company has so far managed to get 11 patents.

- Natural Products: During the year we completed standardization studies on five projects for natural products. Out of this five, Immumax – an immunomodulator was launched in the last quarter of the year. NPIL has an ongoing alliance with CDRL, Lucknow and more alliances with other CSIR's are under discussion.

- Contract Research Organization: Wellquest- Contract research organization became fully operational and received its first overseas project for clinical research.

- Genomed: NPIL took a major initiative by entering into a knowledge partnership with Center for Biochemical Technology to form GENOMED. Two laboratories are being set up in Mumbai and Delhi respectively with requisite infrastructure and scientists from leading Indian and international research institutes.

New Acquisition and Alliances – Rhone Poulenc (India) Limited

Last year in the Chairman's Letter to the shareholders it was indicated that the Company will continue to seek out synergistic and win-win acquisitions / partnerships in the domestic as well as international markets. We are pleased to report that the Company was successful in acquiring control of Rhone Poulenc (India) Limited (RPIL) inspite of stiff competition from many leading international and domestic pharmaceutical companies. The Company's track record of acquiring pharmaceutical companies and turning them around into highly profitable operations and integrating them smoothly without any problems seems to have helped us to acquire RPIL despite serious competitions from several bidders.

In December, 2000 the company acquired through its wholly owned subsidiary NPIL Fininvest Ltd. 40% of the equity held by May & Baker Ltd. of U.K. in Rhone Poulenc (India) Ltd. at a price of Rs.875/- per share. Further in compliance to SEBI regulations, the company made an open offer to the remaining public shareholders of RPIL and acquired an additional 20% equity at the same price. With the acquisition of RPIL, the Group's pharmaceutical ranking in ORG has jumped to second position. RPIL has a profitable formulation business with leadership in Respiratory, CNS, Anti Parasites, Anti Histamines, Gastro Intestinal therapeutic areas. Its brands like Phensedyl, Gardenal, Flagyl, Essentiale-L, Phenergan, Stemetil etc. enjoy very strong brand equity among the medical profession.

NPIL stands to benefit considerably from the acquisition of Rhone Poulenc (India) Limited by :

a. Enhancing NPIL's leading presence in the domestic pharmaceutical market by adding a portfolio of strong brands with excellent profitability and growth potential.

b. Adding an experienced sales force of around 400 to NPIL's sales force creating a stronger sales and marketing infrastructure.

c. Enhancing NPIL's capability of launching several new products from its own R&D and from that of alliance partners.

d. Creating a potential for cost synergies and efficiencies which would contribute to overall profit improvement.

NPIL-Dr. Phadke Pathology Laboratory & Infertility Center Limited

The shareholders will recall that, last year the company as a part of its strategy of achieving leadership status in healthcare, made its maiden foray in Pathlabs business by acquiring 90% stake in a reputed pathlab in the city of Kolkata. During the year, the company invested Rs.5.58 crores towards 60% equity in the new Joint Venture - NPIL-Dr. Phadke Pathology Laboratory & Infertility Center Limited (Dr. Phadke). This is in continuation of our strategy of establishing state-of-the-art Pathology Laboratory in the metro and mini-metro cities in the country and networking them into centres of excellence providing the latest diagnostic services to the patients / medical profession. Dr. Phadke is a reputed Pathology Laboratory in Mumbai specialising in Infertility diagnosis and treatment.

FINANCIAL HIGHLIGHTS

Income Statement

Rs. Crores

		Year Ended 31st March, 2001	Year Ended 31st March, 2000
Sales		**566.8**	486.5
% Growth		**17.0%**	
Dividend from JV's		**3.0**	7.8
Other Income	- Operating	**11.4**	7.7
	- Non Operating	**(1.6)**	2.8
PBIDT		**97.2**	84.7
% to Sales		**17.2%**	17.4%
Interest (Net)		**9.6**	11.2
Depreciation		**13.9**	10.6
Profit Before Tax		**73.7**	62.9
Taxes		**7.0**	7.3
Profit After Tax		**66.7**	55.6
% to Sales		**11.8%**	11.4%
% Growth		**20.0%**	

Sales

Sales during the year registered a growth of 17% over the previous year. Detailed analysis of sales are explained earlier in this report.

Other Income

The dividend from Subsidiaries and Joint Ventures decreased from Rs.7.72 crores last year to Rs.2.93 crores in the current year mainly on account of the interim dividend declared by Gujarat Glass Limited / Sarabhai Piramal Pharmaceuticals Limited last year against none during the current year.

The non-operating loss during the current year is on account of the loss arising from the sale of company's 49% stake in Scholl Piramal Ltd. whereas in the previous year the company had realised profits by way of sale of investment in mutual funds.

Profit Before Interest, Depreciation and Tax (PBIDT)

PBIDT before other income increased from Rs.66.4 crores last year to Rs.84.4 crores in the current year i.e. an increase of 27% indicating operating margin improvement of 1.3%. This was achieved by a combination of the following:

a) Higher growth in the high margin business of formulations;

b) Cost reduction and profit improvement programme across all operations in the company;

c) Increased contract manufacturing income by full use of surplus capacity of plants.

The profits would have been higher but for certain external adverse factors like :-

i) Reduced realisation in Vitamin A business due to imports and low off-take in Poultry segment.

ii) Reduction by NPPA in prices of certain formulation - Bactrim and Omnatax.

Interest

Interest expenses declined to Rs.9.6 crores in the current year as against Rs.11.2 crores in the previous year. This was mainly due to the continuous efforts to reduce the cost of borrowings and receipt of interest on income tax refunds.

Depreciation

Depreciation expenses increased to Rs.13.9 crores in the current year from Rs.10.6 crores in the previous year. Increase in depreciation expenses was mainly on account of full year's amortisation / depreciation charge on brands acquired during the last quarter in the previous year, Haemaccel manufacturing facilities acquired in February 2000 and expansion of Mahad manufacturing facilities which was completed in the current year.